The French Monetary Management in the Inter-war Period: the Dismissal of Open Market Procedure?

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(first draft)

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***Abstract*:**

The notion of *rule* surrounded the gold standard system. For instance, it is not seldom to present the gold standard system under the 1925 Keynesian expression as the *rules of the game*. However, it is nowadays quite crystal clear that gold standard system was not such a self regulating system in which automatic rules prevailed (Eichengreen 1996; Mouré 2001). At the same time, the behaviour of the French bank of issue in the inter-war period gave rise to polemic (Nurkse 1944). The paper proposes to examine the conduct of the French monetary management in the inter-war period by focusing on the context and behaviour adopted by Bank of France. Three points emerge from the study. (1) Before explaining the way franc was managed, we need to make a short recall on the state of the French economy after WWI and on the way the French banker system functioned. (2) The monetary management implemented by the Bank of France is both characterized by a discount rate policy and by the total rejection of *open-market* operations. This way of managing the franc can be explained by the French historical background and by the conflict between the two leading economists of the moment: C.Rist and P.Quesnay. (3) In order to illustrate the French monetary policymaking the paper will expose the peculiar policy implemented by Bank of France between 1928 and 1932. This way of behaving -based on the gold gathering at the expense of the other countries- was roughly criticized in Europe since France was accused of being responsible of the 1930's international depression.

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*No other period (*i.e the inter-war period*) of equal duration affords so great a variety of experience; in no other period were so many experiments deliberately or fortuitously undertaken; in no other period was the influence of extraneous events on monetary relations or of monetary policy on economic conditions greater.*

Loveday 1944
Preface of Nurkse's report for the League of Nations

Loveday's quotation from the League of Nations' report, concerning the *International Currency Experience*, is sufficient to demonstrate how peculiar the inter-war period was. Particularly on the monetary side. If it is well known that the thirties' years were a period of "*High Theories*" (Shackle 1967), it was also the years of high fluctuations for the currencies and for the international monetary system. WWI has not only changed the boundaries within Europe since it has also transformed the way money is managed. It is right that all the banks of issue, or central banks, had the same goal: preserving their gold, or metallic, reserves from depletion. Thus, the way to reach it differed even if the discount rate was the prevailing instrument. One striking point is that monetary macroeconomics has been enriched by the first works on monetary *rules* or *norms* at the same period as the Gold Standard was in practice. The first economists who were at the origin of the rule based approach were the Swedish forerunners : K.Wicksell and G.Cassel. The corner stone in monetary theory dated back from Wicksell's seminal book, "*Interest and Prices"*, in 1898, but his ideas and monetary advice will be disseminated ten years later. It is not only before Wicksell's lecture in front of the British Economic Association that the notion of "monetary norms" will appear[3]. The idea, or the norm, was to fill in the interest rates gap, between the monetary rate and the natural rate, according to the fluctuation of the level of prices. As stated by Jonung (2002, p.187) the Wicksellian monetary rule can be defined as follows "*the central bank shall keep the price level constant by adjusting its discount rate so that the loan rate of the commercial banking system always remains at par with the natural rate*". It is right that the notion of rule surrounded the inter-war period due to the line of conduct imposed by the Gold Standard system, notably the gold parity and the gold points. The expression of the "*rules of the games*", introduced by Keynes in 1925, in "*The Economic*

[3] Wicksell K., 1907, "The influence of the Rate of Interest on Prices", *Economic Journal* XVII, pp. 213-220.

Consequences of Mr. Churchill", is a leitmotiv for dealing with the gold standard system. Jonung (1979) has demonstrated how the framing of the Swedish monetary policy in the 1930's was mainly influenced by Wicksell's works, notably his norm of price stabilization. However, Eichengreen (1998, p.28) advices us to be *suspicious* with this kind of belief by denying whatever kind of "*rigid code of conduct*" (ibid) for central banks in the inter-war period. The literature on this period and on this topic is quite rich. Nevertheless, it is surprising that the study of the French monetary experience is quite a virgin land. In a book in honour of the seventieth birthday of Fisher, untitled "*The Lessons of Monetary Experience",* all the major countries and central banks witnessed concerning their monetary experiment in the inter-war period unless France. What shall we understand ? Has France learnt anything from this period?

The goal of this article is to fill in this gap by focusing on the French monetary management between WWI and WWII. The purpose is to give a clear statement on the management of the franc during this erea. At the same time we will put forth the reasons behind the peculiar line of conduct adopted by Bank of France. Several points emerge from this study. (1) Before explaining the way franc was managed, we need to make a short recall on the state of the French economy after WWI and on the way the French banker system functioned. (2) The monetary management implemented by the Bank of France is both characterized by a discount rate policy and by the total rejection of *open-market* operations. This way of managing the franc can be explained by the French historical background and by the conflict between the two leading economists of the moment: C.Rist and P.Quesnay. (3) In order to illustrate the French monetary policymaking the paper will expose the peculiar policy implemented by Bank of France between 1928 and 1932. This way of behaving -based on the gold gathering at the expense of the other countries- was roughly criticized in Europe since France was accused of being responsible of the 1930's international depression.

I. The French background and the state of the economy

If we want to give a thorough explanation of the way money was managed in France in the inter-war period, we need, first, to restore the facts in their context. So, a short recall on the state of the country after WWI and on the way that the bank of issue, i.e the Bank of France, functioned seems to be necessary (1.1). In line with that, we will see that the fiscal policy was quite inadequate since it encouraged the devaluation of the franc.

1.1 France after WWI and the inaccuracy of the fiscal policy

In allusion to Warburg's quotation, Rist (2002 p.516) advanced that during war times "money stops being an *anvil* for becoming *hammer*". So it was for France after WWI. The over issue of paper-money, such as the issue of "*Bons de la Défense Nationale*" and "*Bons du Trésor*", have brought about price movements which hit the whole society. The free, not to say excessive, fluctuation of the currencies is one of the main feature of the international monetary organisation after WWI. Most of the European countries, particularly France, Great Britain and Germany, got bogged down in deficits and suffered as well from a low level of gold reserves. As a consequence, the gold convertibility of the currencies was suspended awaiting the return of a more quiet climate and at the same time, the currencies got depreciated. For instance, the franc was just valued at one fifth of its dollar value until the end of 1926. It is only in 1928 that the convertibility of the franc was legally restored. As stated by Eichengreen (1996 p.47) "*the first half of the 1920's thus provides a relatively clean example of a floating exchange rate regime*" since central banks did not intervene in the exchange market. It is true that after the WWI, the world has totally changed. Due to the huge costs of the war the former leaders (Great Britain, Germany, and France) became the losers. Until the stabilisation of the national monetary units in Europe, money was the target of all the fears and hopes. So to say, the exchange rates reflected the doubts and the suspicions towards the capacity of the respective governments to undertake the conjuncture and to pay back its loans[4]. At the same time, each favourable piece of information brought

[4] The French Parliament voted in 1920 a law which forced the government to disburse, 2 billions a year, the loan brought by Bank of France. However, in 1922 after a succession of depart from the rule, the franc was pushed once more to depreciation.

about an appreciation of the national currency and a better reliance on the near future[5]. France was accused, notably after the publication of Nurkse's report in 1944, for not having reacted against the excessive fluctuation of its exchange rate which brought about prejudicial consequences for other countries, particularly in terms of gold flow[6]. There are two features in the French monetary history that prevails in the interwar period: (1) the return to the Gold Standard System with the monetary Law in June 25th 1928, known as the *stabilisation Law*, which established the new gold parity for franc at 65.5g per unit and required Bank of France to hold gold equal to 35 % of its notes and deposits; (2) the Law of July 24th in 1936 which modernized the status of the Bank of France, notably by strengthening the government control on it[7]. For all those reasons the paper focuses on the period which starts from 1926 since before that French government was more implicated in the reconstruction of the country, and by doing so, the reconstruction of the economy rather than managing the franc[8].

The negative impact on franc of the 1925-1926 French fiscal policy

According to Jonung (1979 p.486) we can divide economists into two groups regarding the discussion on the stabilization policy: the ones who favoured a Quantity approach with a special focus set on monetary policy, and the other ones who are more inclined towards a fiscal policy. Concerning the French case, it seems that the second one prevailed. However, the fiscal policy was rather "inappropriate" (Eichengreen p.76). The franc was quite instable particularly between 1925 and 1926[9]. In fact, in 1924 Poincarré's Center-Right government imposed an increase in indirect income taxes. Yet, this

[5] For instance in 1921 when Germany had been forced by the Allies to disburse the total amount of 31 billions of francs, the French currency got strengthened. On the contrary, when the Expert Committee published in 1922 a negative report on the capacity of Germany to reimburse its own debts, the franc fell down. (Eichengreen p.73)

[6] The fluctuation of the franc as well as the inflation process during the after war period and until 1924 can both be explained by the huge public deficit and by the financial support brought by Bank of France to the government in place. As a consequence people mistrust in the near future and formed negative forecasts. As a result the depreciation of Franc went increasing.

[7] This stage will be follow few years later in December 2nd 1945 by the nationalization of the Bank of France. It is only from this event that Bank of France became a real central bank in the right sense of the word.

[8] For more details concerning the monetary management before 1926: few elements can be found in Blancheton 2001, Part I, chapters 1 and 2; and also in Eichengreen 1996, chapter 3.

[9] For instance, in the beginning of the year in 1925 one dollar valued 19 francs whereas in July 1926 one dollar did worth 41 francs.

coalition has been brought down by a Center-Left government, leaded by Herriot, and so it was regarding its fiscal policy. Investors feared that the new government should substitute wealth and income tax for Poincarré's indirect impost. As a result, wealth holders *got rid of* their assets out of the country. They exchanged their Treasury bonds and other franc-denominated securities into dollar or sterling denominated securities in London or New York banks. Consequently, the rate of exchange dived with a self-fulfilled expectation process. As underlined by Eichengreen (1996 p.56) "*The more investors transferred their assets out of the country, the stronger became the incentive for others to follow*". We have to notice that the political instability between 1925 and 1926 in France brought about an unfavourable context which encouraged in itself the *franc drain*[10]. Fortunately the dynamic of the foreign exchanges, which was the outcome of the franc depreciation, brought about a surplus in the balance of payments. As a result, the Bank of France reconstituted its gold reserves. In short, the monetary management in the interwar period was essentially based on the discount rate as a guideline for the monetary goals[11]. This kind of policy making can, partly, be explained by the French historical background.

1.2 The French banker structure

In period of reconstruction the own role played by the bank of issue is not without importance. At its origins the Bank of France, created in 1800 by Napoleon, aimed at extending low discount loans in order to boost the economy. It received the monopoly from the government in 1848 for issuing bills within the whole country[12]. Each times this monopoly was restored, the French government was more and more demanding in terms of returns for this privilege, notably by pushing the bank to open new bank branches in the whole country (Mouré 1998)[13]. From its creation until December 2nd

10 Between 1925 and 1926 the French government changed five times in only 14 months.

[11] Mouré (1998 p.228) : « on s'en tenait aux modifications du taux d'escompte pour défendre le franc et pour faire face aux besoins de crédit du marché intérieur. »

[12] The monopoly for issuing bills was received by the Bank of France earlier than 1848. In reality the bank was authorized to issue bill in 1803 at the same time as the creation of the *Germinal franc* . The latter was valued at 5 silver grams. Yet, those bills were just legally accepted in Paris. Step by step, the network of the bank expanded and it is only in 1848 that the French bills had legal circulation in the whole country.

[13] This clauses is not without consequences for the Bank of France in the extent it pushed the bank to run more and more after profits in order to offset the increasing costs due to the opening of new branches.

1945, the Bank of France was a private institution owed by shareholders. The power within the bank was concentrated into the hands of the Governor who was both Director of the bank and President of the Council[14]. However, in spite of its private status, the political power was not without authority on the Bank of France since the French Minister of Finance designed, and could fire, the Governor. This hybrid situation is peculiar of France[15]. In the other countries such as Great Britain or Sweden, the issuing bank aimed most of the time at serving the government without any preoccupation for profitability[16]. This is the criterion which is required for being a "real Central Bank" according to Goodhart (1988). In fact, "it was the metamorphosis from their involvement in commercial banking, as a competitive, profit-maximizing bank among many, to a *noncompetitive non-profit-maximizing* role that marked the true emergence and development of proper Central Banking" (*ibid* p.9). In the French case, the competition prevailed between the banks and particularly between the Bank of France and the commercial banks. Since the banker's profits came mainly from the discounting of the commercial papers such as the bills of exchange, the bank of issue was pushed to increase its *commercial* activity by discounting more and more bills of exchange at the expense of the other banks[17]. It is true that the Bank of France had a "comparative advantage" related to the other banks taking into account its network of branches. Thanks to that it could easily discount more commercial papers and by doing so increased its margin. So to say, the Bank of France was bogged down in a conflict of interest between its role as a central bank which consisted in providing the liquidity to

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14 This council is called *Conseil des Régents* and it was composed by 18 members (15 regents and 3 censeurs), essentially bankers, and it was elected by the 200 most important shareholders of the bank.

15 In his monetary historiography of the major Central Banks Goodhart (1988,p.9) stressed the case of he Bank of France which "retained for a considerable time a large role in ordinary commercial banking". Goodhart also underlines the *hostility* (p.117) from the Bank of France towards the others commercial banks even when there was no direct note issuing competition.

16 From its creation in 1694 to now the Bank of England have acted as the Government's banker and debt manager which it continues today. Throughout its history the Bank has always seen itself as a public institution, acting in the national interest. Although privately owned, for much of its life, the activities which it undertook were determined by it governing legislation and by the relationship with government. Nationalisation in 1946 did not greatly affect that; but it meant that the Bank was owned by the Government, rather than by private stockholders, and gave the power to appoint the Governors and Directors to the Crown.

17 In this period the banker structure was heterogeneous. There was 3 kinds of bank : the *commercial banks* which were mainly in charge of the private deposits and the short term credits in the whole country; the *business banks* which were essentially located in Paris and which were more specialized in the international credits for business purposes; the third category of bank, called *regional bank*, were a sort of hybrid banks which mixed the activity of the two firsts.

the banker system and its own commercial activity as a business bank[18]. Mouré (*ibid*, p.214) exposed this ambiguity as follows: "*Bank of France created a conflict between its financial interests and its role as a leader in the money market because it was in a situation of direct competition with the commercial banks*"[19]. The same opinion regarding Bank of France emerged from Goodhart in his historiography on the "Evolution of Central Banks".

In his study of the Bank of France Mouré stresses the everlasting independence between the bank of issue and the French government while underlying the *ambiguity* concerning the degree of independence between those two powers. One of the weak points in this topic is that the monetary management partly depended on the personality and character of the Governor. According to the person at the head of the Bank of France, the degree of independence and the relationships with the Minister of Finance were fluctuating. For instance, the Governor Moreau (1926-1930) was exceptionally independent related to both the government and the Council's members whereas his successor- the Governor Moret (1930-1935)- was more inclined to be a *civil servant* (Mouré 1998 p.211). Due to the bureaucratic functioning of the Bank of France, each conflict with the Council was prejudicial for the success of the guide lines given by the governor. So it was through Moreau's period. During his term of office Moreau tried to reorganise the monetary market in Paris in order to reverse the relationship between the Bank of France and the monetary market. The idea was to lead and to run the market instead of following it. Yet, the permanent divergences with the council's members pushed him to resign in September 1930. There is no doubt that governor Moreau was the only one who had a forward-looking vision of the monetary management since he tried to establish in France a modern monetary organization. The idea was to substitute the discounting activity and the accumulation of gold by an *active management* of the domestic credit market. So to say, Moreau tried, but without any success, to introduced with the help of Quesnay, the open market operations. They aimed at increasing the proper role of the Bank of France as a central bank at the expense of its commercial activity. However, this objective was not to be reached before the nationalization of the bank of issue in 1945.

[18] As it appeared in personal communication or newspaper in this period, the Bank of France was not considered as a central bank but rather as a commercial one.
[19] The translation is mine.

II. The French Monetary management in the inter-war period

If we want to put into the light the way franc was managed during WWI and WWII there is no doubt about the fact that the key elements of the monetary management lies in the preference of a discount rate policy (2.1) and in the everlasting rejection of the open market operations (2.2).

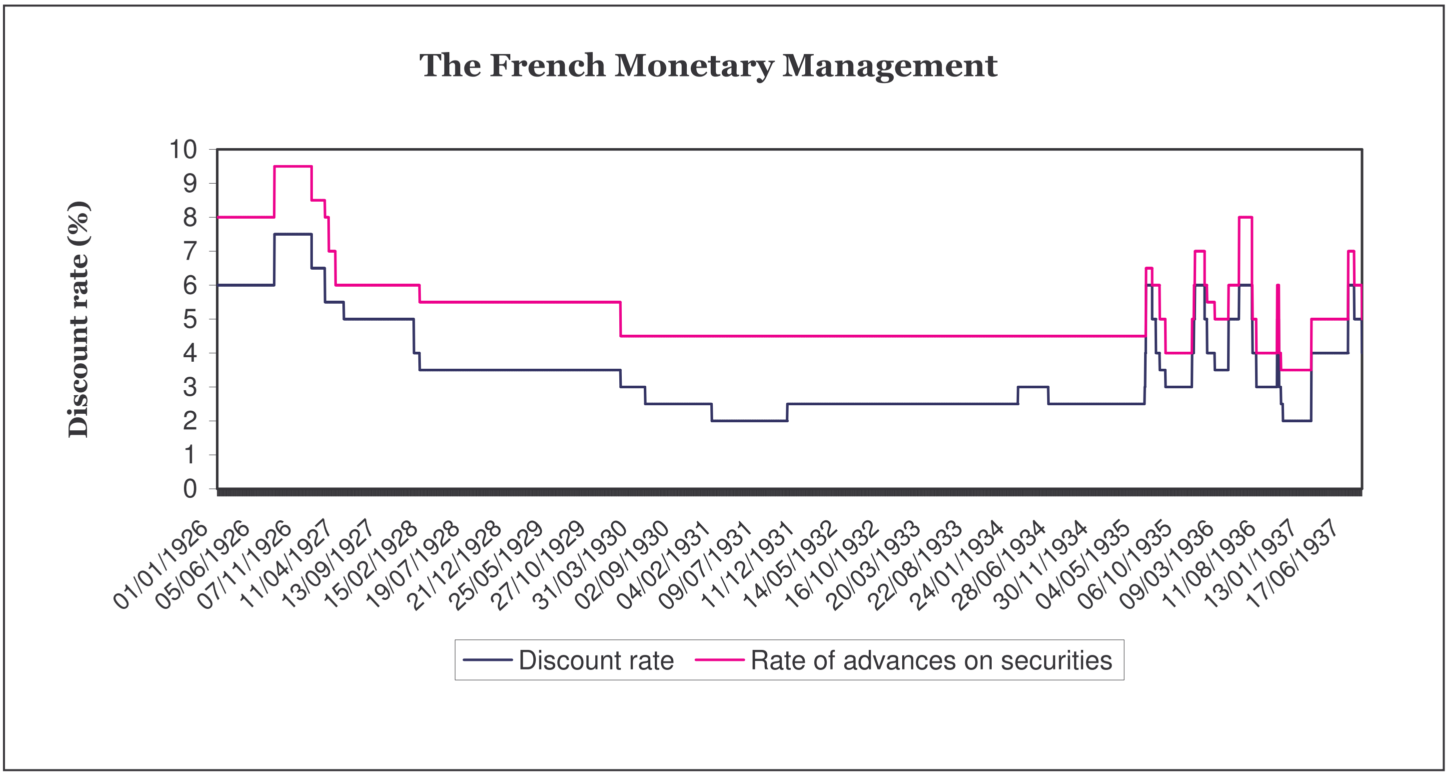
2.1 A discount Rate Policy: the prevalence of stability.

As long as money is exogenous it is difficult to use the term *monetary policy*. That is the reason why we will use the term *monetary management* instead of it. The strategy implemented by the Bank of France is featured by a discount rate policy. As a result of the adherence to the Gold Standard System and due to the inheritance of the pre-war habits, the discount rate was the prevailing instrument for the currency gold attachment. It is often presented as a good means to protect the economy from the influx/outflow of gold. When there was a risk of gold depletion, the central bank, or the bank of issue, increased its discount rate in order to discourage the convertibility of the notes into gold and to encourage the capital flow. In fact, the discount rate was a strong monetary tool in the sense that it allowed to restore the level of the balance of payments without "gold stream". The famous economist Charles Rist was a great supporter of this kind of policymaking. In his famous and thorough survey of the monetary doctrines, entitled *Histoire des Doctrines relatives au credit et à la monnaie* (1938), he puts forth the discount rate -instead of the open market operations- as the exclusive monetary instrument. The first one uses the interest rate channel whereas the second one operates through the market channel. The French particularity lies in the *schizofrenia* for stability concerning its discount rate[20]. As stated explicitly by the Governor Moret in the General Council meeting on the 24th of May 1934 :

[20] Even in a context of international decrease of the discount rate France was an isolated case since it refused to diminish it. So it was in May 1931 when most of the major central bank (London and New York) reduced their discount rate France kept on mantaining its rate unchanged.

"The traditional policy of the Bank of France, with this difference of the one used by the other central banks, aimed at the stability of discount operations. It has always tried to rarefy the fluctuation of the discount rate as much as possible and when it was not the case it was only because the need arisen. " [21]

The monetary goals, not to say monetary rules, during the inter-war period were both to peg the franc with its gold weight parity, *i.e* one franc valued 65.5 g. of gold, and to run the internal monetary market. The monetary management essentially used the discount rate as a guideline for its strategy. However, sometimes it happened that the domestic economy had needs that did not agree with the ones of the international context. So to say, sometimes internal and external requirements were in divergence. It was for these reasons that Bank of France had in its hands two monetary instruments: the discount rate and the rate of advances on securities. In fact, the Bank of France used the latter as the instrument for internal purposes, *i.e* the liquidity of the banker market, whereas the former was employed for international reasons, *i.e* the gold parity of the franc and the protection of the gold reserves. The graph.1 shows us a survey on the general movements of those two rates between 1926 and 1937[22].



[21] The translation is mine.
[22] Data from the Archive Department of the Bank of France.
Reference : 1060 2004 01 / 277

One of the striking points is the almost perfect simultaneity of the changes in those two monetary instruments. The only exception to that rule is the period between January 31st 1930 and May 25th 1935 in which the discount rate fluctuated while the rate of advances on security was steady. In fact, because of the decrease of the discount rate abroad from May 1930 to January 1931, notably in London and New York, the French discount rate had to decrease so as to reduce the gold influx. However, at the same time the internal objectives for credit asked for a reverse movement. In order to cut this conflict, the Governor Moret reduced the discount rate to 2 % because of the international monetary context but the rate of advances on securities was maintained at its same level. The intention was to send a signal to the market that the Bank of France did not want to stimulate credit within the country even if its discount rate decreased.

The French monetary management is not only featured by the prevalence discount rate policy but also by its attachment in favour fixity. In fact, if we have a look on the French monetary history we can clearly stress that tradition, not to say routine, is a sort of leitmotiv for France. This static behaviour in the policymaking has a long run roots. Vuillaume (2004) puts forth a sort of *hysteresis effect* justified by the legacy of the *Caisse des Comptes courants* which was one of the Bank of France's seniors. It seems to have transmitted to the Bank of France its schizophrenia for the stability of the discount rate as well as the practice of strict selection of the bills of exchange. One of the reasons lie in the initials goals given to the genesis of Bank of France[23]. As the bank of issue was originally created in order to serve the "*needs of commerce*" (Goodhart 1988 p.116) stationary prevailed. The approach adopted was that a stable environment guaranteed by a quite fixed discount rate is better than an environment in agreement with the vagaries of the macroeconomics climate -notably the fluctuations of the capital market or the variations of the metallic-currencies reserves. Vuillaume (2004) stresses the fixed discount rate policy established by the Bank of France between 1820-1847 as a *dogma* which guided its line of conduct. If we compare the discount rate changes with the ones of the two major banks of issue in Europe -even in an earlier period- it is crystal clear that the changes in the discount rate were a common habit for both England and USA

[23] In his introduction, Vuillaume (2004 p.2) quotes a letter from Napoleon to the Ministry of Public Treasury, dated back from 1814, concerning the goals of the Bank of France. He wrote as follows: "What is the goal of the Banque de France ? To discount the credits of all the companies in four percent" (The translation is mine)

whereas France favoured stability[24]. During 1897 and 1910 France changed 13 times its discount rate whereas England and Germany changed respectively 76 and 60 times.

The particularity of the French policymaking in the inter-war period was not only its fixed discount rate policy but the exclusiveness of its instrument. In fact, most of the major banks of issue in the other countries, with some degree of difference, used for the most part the open market operations whereas France refused to take advantage of it[25].

2.2 The Rejection of the *open market* procedure

The open market procedure has a long history life in France and it was at the origin of a debate within the Bank of France's economists. In fact, the conflict opposed in the late 1920's on one side Pierre Quesnay-supported by the Governor Moreau- in the group of the supporters, and, on the opposite faction, Charles Rist. The economists wondered whether the Bank of France should use "open market operations" in its monetary armoury. Both were in agreement with the necessity to set up reforms in order to expand the power of the Bank of France in the late 1920's and the early 1930's. So, the Bank of France adopted both fiscal and monetary regulations in 1928/1929. Contrary to what is written by Eichengreen (1996 p.66) about France open-market was not totally *prohibited*. The 1928 monetary law allowed the bank to buy or sell short terms bonds *for the account of foreign central banks*[26]. The rule stated that the bank of issue could buy the bills of exchange with a minimum amount of 50 000 French francs and the bonds needed to have no more than 90 days validity. Due to that regulation the first discounting company, called *Compagnie Parisienne de Réescompte*, has been created in order to proceed to these indirect open market operations. On the clan of the defenders of *modern* policymaking Pierre Quesnay -supported by the Governor Moreau- was enthusiastic with this kind of measures taken and he attempted to set up open market

[24] See in Appendix the graph on the discount rates of the major central banks between 1929 and 1936.
[25] We have to notice that the Bank of England was one of the first which used open market operations in its monetary management. One of the primary need for this kind of policymaking was a widespread Treasury bonds market. That is the reason why England was a single case in the 19th century. In the next years, after the classical gold standard in 1913, the Bank of England has been followed in its preference for open market by the German central bank in Berlin, by the central banks from Belgium, Sweden, Switzerland and Austria-Hungary.
[26] This solution has been used during the collapse of the Sterling in 1931. Bank of France bought sterling for the account of Bank of England in order to sustain the gold value of the British currency.

operations within the monetary instruments. Before being the General Manager of the Bank for International Settlement between 1930 and 1937, Quesnay was the Director of the economical studies department in the Bank of France (1926 to 1930). Quesnay was a defender of an international cooperation between nations owing to the peculiar inter-war context[27]. All of that justifies in itself to gather the worldwide strength and to act in the same way. He declared on this subject to Siepmann in 1928 august 16th the following:

"*If we restrict ourselves to a discount rate policy while the other central banks focuses on an active management of the currency, we will bring about prejudicial fluctuations in the capital market; and I am convinced that far from participating in the regulation of the international credit market, we will disturb it.* "(*in* Mouré 1998 p.226)[28]

The governor Moreau and Quesnay hoped to take advantage of those new directives in order to strengthen the monetary control of the Bank of France and also in order to balance the metallic cash holds by the bank. However, inside the bank of issue the open market proposal was not welcomed by everybody, particularly not by Rist the deputy governor. Since 1926 Rist was at the second powerful rank within the Bank of France. He was inclined in favour of a return to the pre-war monetary conditions -such as the free circulation of the gold coins- and sceptical with the efficacy of the open market procedure. Added to that, Rist was totally opposed to whatever form of a monetary market in Paris which could provide and regulate the liquidity needed by the private banks. We have to keep in mind that most of the officials' members in the Bank of France -among them Rist- had a negative background concerning the open market practice. They were convinced that this instrument was at the origin of both inflation and crisis[29].

We have to admit that Rist won the debate since open market has not been used in France before 1938 (Flohic 2001). This victory is not essentially due to the greater influence of Rist within the Bank of France but it is also attributable to the tendency that prevailed in France for static, not to say traditional, behaviour. The rejection against

[27] During a conference in 1932 Quesnay stated that: "*It would be an illusion to consider that we can reach monetary internationalism without internationalism on its own*." (1932, p.79).

[28] The translation is mine.

[29] Mouré (1998 p.223) sums up the general opinion as follows: "the bank (*bank of France*) refused to use open market opérations due to the belief that they were responsible for the international depression and the collapse of the *gold standard*."

open market is not a French *caprice* since this position lasted. During the 1931 Sterling crisis episode the Governor Moret refused once more the British proposal made by Sir Leith-Ross to set in open market procedure in the monetary management.

The monetary regulation taken in the end of the twenties was not welcome abroad. The 1944 League of Nations's report is a perfect synthesis of the way France was judged by the other countries. In his report Nurkse roughly criticized the French policy during the inter-war period. More than a criticism it was a condemnation that he pronounced. He accused France of being widely responsible of the collapse of the gold standard. If France "*played an important role in the breakdown of the system*" (*Ibid*) it is due to its 1928 monetary Law. In fact, this law "*decided to take nothing but gold in settlement of the enormous surplus occurring to her from the repatriation of capital and from the current balance of payment*" (Nurkse 1944 p.39). Because of that, a large part of the gold flow went in direction of France which forced the other countries to accept a gold drain in their reserves. We will see thoroughly this peculiar policy later in the article. Added to that, the huge French gold imports, which were used to convert the foreign assets into gold, had brought about a depressionary effect on the other countries, particularly England which abandoned later on its gold pound parity.

III. <u>The French Gold Accumulation Policy as a perfect illustration of the French monetary policymaking</u>

During the inter-war period, France was a sort of isolated case regarding the way franc was managed. However, France also attracted attention due to its peculiar policy implemented between 1928 and 1932. During this period, it was not welcomed to be French! The increasing French gold reserves and its consequences on the other countries attracted critics. France was accused abroad to exert a "financial dictatorship on Europe" (Einzig 1931)[30].

[30] See in Mouré 1998 footnote 15 p.425.

3.1 The French heterodoxy during 1928 and 1932

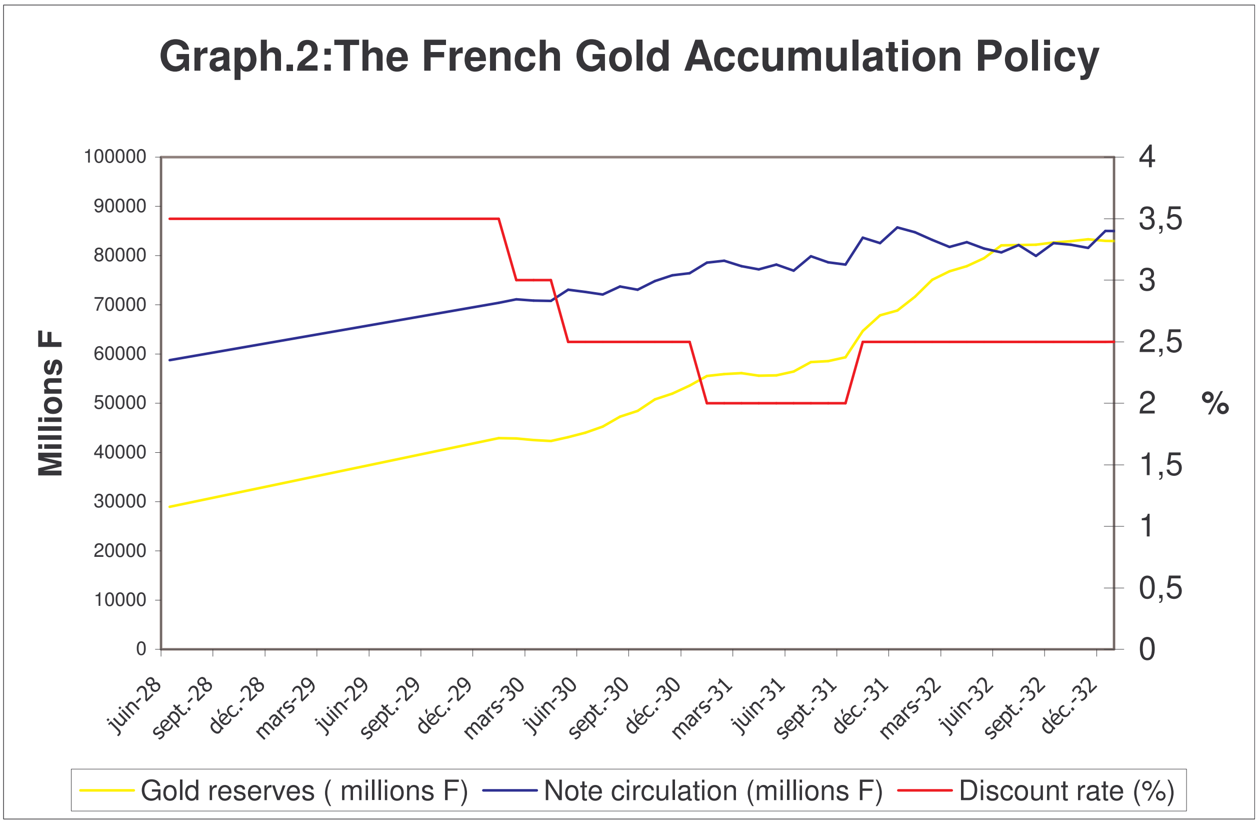
From 1928 to 1931 there were rough tensions between France and Great Britain due to the French behaviour which was seen abroad as a means to reach a "political lever in Europe" (Mouré p.133)[31]. In fact, France was roughly criticized due to its *heterodox* policy which consisted in increasing its level of gold reserves while leaving unchanged the discount rate. Between 1928 and 1932, the gold reserves in the Bank of France went from 29 billions to 82 billions of francs while the note issuing increased for only 22 billions of francs (Mouré p.133). In this same period the discount rate was reduced of only one point from 3.5 % to 2.5 % whereas the gold reserves reached their highest level. In 1932, France owed 27.3 % of the total amount of gold reserves in the world. After the USA which owed 34 % of the world gold reserves, France was the second richest country[32]. This *gold accumulation policy* was not without consequences for the other countries. By refusing to move the discount rate in agreement with its increasing gold reserves, Bank of France brought about large outflow of capital and gold in its direction. As expressed by the French economist Cauboué (1928):

"The discount rates in several different countries are seen as locks which solved the circulation of capital all around the world. By changing the height of these locks, we can call the capital back or, on the contrary, make it flow back" (Cauboué 1928 p.87)[33]

All of that forced the other countries to accept a gold/capital drain in favour of France. As shown by Graph.2 the amount of gold reserves went increasingly while the discount rate was quite unchanged between 1928 and1932[34]. We have to note that Bank of France, through the Governor Moret, considered that the discount rate had a lower limit from which the bank must not depart. Under a 2% rate Bank of France considered the situation as prejudicial for the country. In the current literature the discount rate should fluctuaute according to the évolution of the gold metallic reserves. In the French case this Classical analysis does not hold.

[31] This conflict between France and England has been materialised by the bilateral exchange of memorandums : the one written by Sir Leith-Ross (Bank of England) and the other one by Escallier (Bank of France)

[32] See in Appendix the figures concerning the gold reserves owed by Government / Central Banks between 1913 and 1935 in the world.
[33] The translation is mine.
[34] The Graph 2 is based on the data gathered in Mouré 1998 pp.141-142.



3.2 The solution in the French-British conflict

Because of the violent critics and its embarassing level of metallic reserves Bank of France published a *secret* booklet in aid of the French Embassies around the world in order to explain its management[35]. France qualified the gold influx as a "normal phenomenon" (*ibid* p.140). This trend was seen as the result of the decreasing level of interest rates abroad, notably in USA and in England, in parallel with the lack of profitable investments abroad due to the depression. In this unfavourable context, France was a security haven, so that capital and gold come to the "French hexagon". However, this classical, not to say insincerity, analysis was not shared by everybody. Conolly and Sir Leith-Ross in the Bank of England reproached to the Bank of France to "dry' the market of liquidities and by doing so to worsen the depression. This conflict between France and England has been materialised by the bilateral exchange of memorandums : the one written by Sir Leith-Ross (Bank of England) and the other one

[35] This booklet-which aimed at being secret and which was exclusively a tool for the Embassies- had been partly published by the "Times" in 14th November 1930.

by Escallier and Rueff in 1931. One of the possibility proposed by Sir Leith-Ross to solve the conflict was to set up open-market operations which enabled the injection of liquidity through the purchase of bonds or other financial assets. Faithful with the line of conduct adopted for the begininning the governor Moret immediately rejected such solution. The argument was that : "*the open market operations will bring illegitimate profit to the Bank*" [...] and this kind of policymaking was *" an error on principle to finance the purchases of securities through the note issuing*" (Mouré p.148). The French selfishness toward the international context, particularly in the British case, is explained by Mouré (1998) by its faith in the Gold Standard. France trusted in the monetary system and its own capacity of self-regulation. The only changes that did occure thanks to the British memorendum lies in the way the French budget was managed by the Bank of France. After a serie of different meetings and discussions toghether but also in each respective countries, the conflict ended naturally when Great Britain left the Gold Standard in September 21st 1931.

If it is true that the French policymaking was roughly criticized, it is also right that it was also out of date. After WWI the environment totally changed in comparison with the one of the Gold Standard I. So that, the monetary tools or more precisely the monetary strategy which suited before WWI was out of date in the twenties. This is one of the key problems for a number of countries in this "period of instability". In fact, before WWI it was a good means to make the discount rate fluctuated regarding the level of gold reserves[36]. However, this strategy was over after the war due to the unbalanced economic situation and the political environment. Most of the countries have understood that monetary policy pleaded for changes and needed to be updated. That is for this reason that the major central banks, even earlier than the 1920's, substituted a discount rate policy by an open market management. In this subject, France was late. As stressed by Cauboué (1928) regarding France it was a terrible "anomaly" (*ibid* p.87) to keep on managing money in this way in a context in which "only one country really

[36] All the countries did not have the same strategy since their monetary system differed. For instance France used another tool instead of the use of the discount rate in order to protect their metallic reserves. Under the Bimetallism system the Bank of France was allowed to make the convertibility of the money into gold or silver. The choice was function of the level of reserves. Later on, Bank of France was also

allowed to convert the money into gold exclusively in the branch in Paris. The objective was to discourage excessive demand of gold conversion.

functions under the Gold Standard System: the USA" (Cauboué 1928 p.88). Unfortunately, on the legislative side we have no particular answer for understanding the French behaviour in this period. On the contrary, we have a confirmation on the inadequacy between the Bank of France policy and the monetary context -both in internal and external scales. In fact, the French monetary law from June 1928 imposed to the Bank of France to cover in gold the note issuing at the rate of 35 %. In practice, the rate was closer than 40 % rather than the 35 % imposed by the law (Mouré 1998 p.135). During the period studied Bank of France was largely over this rate since in December 1932 the note issuing was covered by gold at the height of 77.29 %. Even when the note issuing went decreasing, Bank of France kept on buying gold abroad through the convertibility of the huge amount of currencies reserves- such as dollar or Sterling- into gold notably between 1928 and the first half of 1929 and also between September and October 1931[37].

To finish, we can remember two features from this episode of the monetary history: *first*, the total rejection of the open market really characterized France; secondly, by refusing to admit that the monetary system changed and that money needed to be managed in a different manner, France demonstrated once more how routine and tradition prevailed.

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[37] The 1928 monetary law cancelled the monetary law of the 7th June 1926 which authorized Bank of France to buy foreign currencies at the market price. So that, Bank of France used its enormous stock of exchange reserves for gold purchases. In November-December 1928, the stock of foreign currencies assets reached its highest level with the amount of 32,641 billions of francs.

Conclusion

There is no doubt about the fact that France was an *isolated case* in an *abnormal instable contex*t. While the fluctuation of the discount rate prevailed in the other central banks, notably the Bank of England, the Bank of France followed a quite fixed discount rate policy. This way of managing the franc, and its dismissal of open market operations are due to its historical background and the French preference towards *routine*. However, the private status of the French bank of issue is also a major reason which explained its *curious* (Nurkse 1944) behaviour.

This article is a first step to a thorough study on the French monetary policymaking during the inter-war. The misunderstanding management implemented by the Bank of France regarding the Classical theory and its own *hybrid* status push us to wonder what was the line of conduct, not to say *norm* that featured in France.

The duties of the Gold Standard system, and the automatic behaviour imposed by such a monetary disciplinary let the doors open to a monetary norm question. Here is the next step that we will take.

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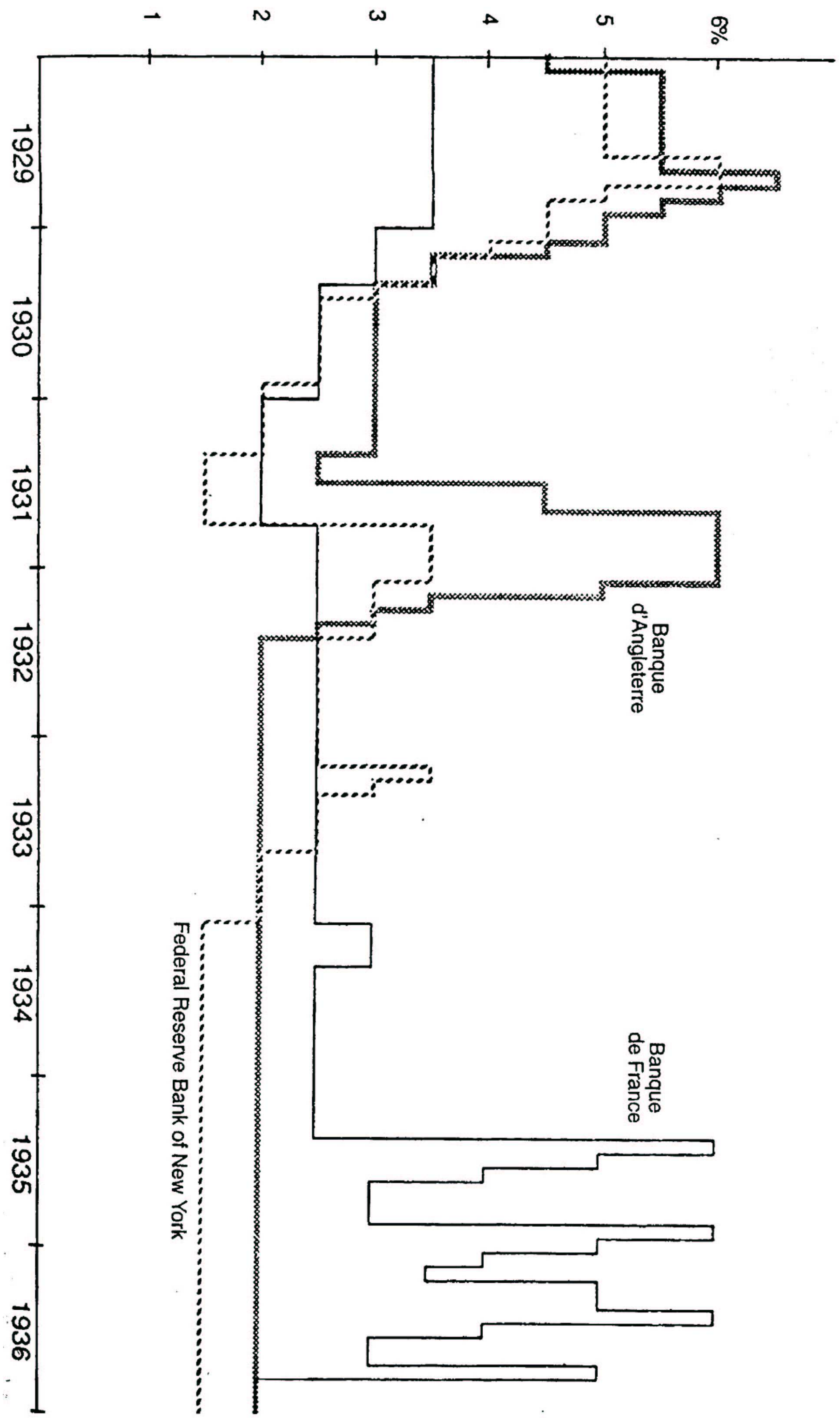
APPENDIX

Discount Rates of the Major Central Banks 1929-1936



Data from Mouré, 1998, La politique du franc Poincaré, Paris: Albin Michel, p.224.

International Gold reserves of Central Banks /Governments (1913-1935)

(in % of the total amount of gold)

Pays	1913	1918	1923	1924	1925	1926	1927	1928	1929	1930	1931	1932	1933	1934	1935
Etats-Unis	26,6	39	44,4	45,7	44,4	44,3	41,6	37,4	37,8	38,7	35,9	34	33,6	37,8	45,1
Royaume-Uni	3,4	7,7	8,6	8,3	7,8	7,9	7,7	7,5	6,9	6,6	5,2	4,9	7,8	7,3	7,3
France	14	9,7	8,2	7,9	7,9	7,7	10	12,5	15,8	19,2	23,9	27,3	25,3	25	19,6
Allemagne	5,7	7,9	1,3	2	3,2	4,7	4,7	6,5	5,3	4,8	2,1	1,6	0,8	0,1	0,1
Argentine	5,3	4,5	5,4	4,9	5	4,9	5,5	6	4,2	3,8	2,2	2,1	2	1,9	2
Australie	0,5	1,5	1,5	1,5	1,8	1,2	1,1	1,1	0,9	0,7	0,5	0,4	-	-	-
Belgique	1	0,7	0,6	0,6	0,6	0,9	1	1,3	1,6	1,7	3,1	3	3,2	2,7	2,7
Brésil	1,9	0,4	0,6	0,6	0,6	0,6	1,1	1,5	1,5	0,1	nd	nd	0,1	0,1	0,1
Canada	2,4	1,9	1,5	1,7	1,7	1,7	1,6	1,1	0,8	1	0,7	0,7	0,6	0,6	0,8
Inde	2,5	0,9	1,3	1,2	1,2	1,2	1,2	1,2	1,2	1,2	1,4	1,4	1,4	1,3	1,2
Italie	5,5	3	2,5	2,5	2,5	2,4	2,5	2,7	2,7	2,6	2,6	2,6	3,1	2,4	1,6
Japon	1,3	3,3	7	6,5	6,4	6,1	5,7	5,4	5,3	3,8	2,1	1,8	1,8	1,8	1,9
Pays-Bas	1,2	4,2	2,7	2,3	2	1,8	1,7	1,7	1,7	1,6	3,2	3,5	3,1	2,6	2
Russie-URSS	16,2	-	0,5	0,8	1	0,9	1	0,9	1,4	2,3	2,9	3,1	3,5	3,4	3,7
Espagne	1,9	6,3	5,6	5,5	5,5	5,4	5,2	4,9	4,8	4,3	3,8	3,6	3,6	3,4	3,3
Suisse	0,7	1,2	1,2	1,1	1	1	1	1	1,1	1,3	4	4	3,2	2,9	2
Autres	9,9	7,8	7,1	6,9	7,4	7,3	7,4	7,3	7	6,3	6,4	6	6,9	6,7	6,6
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Data from Eichengreen (1997) l'Expansion du capital, Paris: L'Harmattan, p.87.